



Committee on the Budget • Majority Caucus
U.S. House of Representatives
Jim Nussle, *Chairman*

309 Cannon House Office Building
Washington, DC 20515 • (202) 226-7270
Rich Meade, *Chief of Staff* • www.budget.house.gov

Economic Update

Volume 3, Number 8

15 November 2004

Data Point to Ongoing Strong Growth JOBS SURGE IN OCTOBER

The U.S. economy continues to grow at a strong pace, with above-trend growth and a falling unemployment rate expected to continue through next year. Recent data for key economic series – including payroll jobs gains, growth of real gross domestic product [GDP], and increases in consumption spending – have been coming in strong, leading most private analysts to upgrade their projections for the second half of this year compared to earlier estimates. Beyond the short-run outlook, solid growth with low unemployment and low inflation is expected to continue for the foreseeable future.

Some challenges exist, however, from factors such as high oil prices. Nevertheless, the Federal Reserve on November 10 raised its target interest rate by $\frac{1}{4}$ percentage point in response to the generally positive outlook for the economy, including the fact that “labor market conditions have improved.”

Recent Data

Recent employment reports have received much attention, showing a stronger-than-expected labor market in recent months and over the past year and a half:

- Payroll employment rose by 337,000 jobs in October, following upwardly revised increases of 139,000 jobs in September and 198,000 in August. Although some of the October gains may be attributed to rebuilding efforts in southern states following the August and September hurricanes (construction employment surged by 71,000 jobs), the overall jobs gains appear to signal a robust labor market (service-producing employment rose by 272,000).
- The Bureau of Labor Statistics [BLS] – the government agency that produces employment data – also reported that “the unemployment rate was about unchanged at 5.5 percent” in October (growth in the labor force exceeded the employment gains), continuing at a relatively low level following the downward trend from 6.3 percent in June of 2003. At current levels, the

unemployment rate is lower than the averages for each of the past 3 decades – the 1970s (6.2 percent), the 1980s (7.3 percent), and the 1990s (5.8 percent).

- In addition to the stronger than expected October jobs report, BLS reported in early October that its annual “benchmark” revisions to the payroll employment numbers would result in an upward revision of approximately 236,000 jobs for the growth in jobs from March 2003 through March 2004. (BLS uses the annual “benchmark” revision to adjust its preliminary, survey-based payroll jobs estimates to account for more complete data.) *Including the effects of the undercount, payroll employment has increased by nearly 2.4 million jobs since August 2003.*

Other data point to continued strong economic activity and real growth, including:

- *GDP growth:* Real GDP rose 3.7 percent at an annual rate in the third quarter according to advance estimates – up from the 3.3-percent growth rate for the second quarter. Over the past six quarters, real GDP has increased at a 4.5-percent annual rate, the strongest continued real growth in 5 years and one of the strongest growth performances in 20 years.
- *Consumption:* Real consumption spending – adjusted for inflation – rose 0.5 percent in September, following a slight 0.1 percent decline in August and a strong gain of 1.2 percent in July. Reflecting those gains, real consumption spending rose at a 4.6 percent annual rate in the third quarter, contributing significantly to the pickup in real GDP growth. Spending growth continued into October, with retail sales up 0.2 percent; excluding autos, sales rose 0.9 percent.
- *Manufacturing and business investment:* The Institute for Supply Management’s purchasing managers’ index [PMI], at 56.8 percent, reached its 17th straight month above 50 (a value above 50 indicates expanding activity). The PMI recently registered its best sustained

(continued on reverse side)

performance in 20 years. Also, manufacturing industrial production is up 5.3 percent over the past year, even with a hurricane-related slowdown in September.

- *Housing and residential investment:* Sales of new and existing single-family houses have continued at or near record high levels in recent months, and housing starts and building permits recently have been at their best sustained performance in more than 25 years.

Despite the positive overall outlook, some noteworthy challenges do exist. They include:

- *Crude oil prices* recently exceeded \$55 per barrel, but have since fallen back to below \$50 per barrel. In real, inflation-adjusted terms, the recent levels have been well below the peak of more than \$80 per barrel (in today's dollars) in the early 1980s. Nonetheless, the high price of crude oil – and its sharp rise over the past year – represents a drag on economic activity and spending. Recently, the national average retail price for regular gasoline has been running at about \$2.00 per gallon, up from \$1.50 a year ago. (In real, inflation-adjusted terms, gasoline prices peaked in early 1981 at about \$2.80 per gallon in today's prices).
- *Consumer sentiment and confidence* have stagnated in recent months, following the strong upward trend over the prior year and a half; but preliminary data show a modest rise in sentiment in the first half of November. Sentiment and confidence hit their post-recession lows in early 2003, then rose sharply into mid-2004. Despite the recent moderation, recent levels are consistent with the economy being in a sustained expansion.
- *The bonus depreciation provisions* of the 2002 and 2003 tax relief legislation – which were intended as a temporary stimulus and allowed businesses to expense up to 50 percent of equipment and software spending – will expire at the end of this year. This could result in a temporary slowdown in business investment spending early in 2005. Private forecasters generally do not expect the effect to substantially slow growth in the economy.

The Outlook

The November Blue Chip Economic Indicators shows that private forecasters, on average, expect above-potential real GDP growth over the second half of this year and continuing through the end of 2005 (see table). Potential real GDP growth – the fastest the economy can grow at full employment without generating inflationary pressures – generally is viewed to be about 3 to 3¼ percent. Reflecting the strong economy, interest rates are expected to rise gradually over the next year.

Last month's Blue Chip survey asked about forecasters' projections for the 10 years from 2006 through 2015. Over the 2006-10 period, for example, real GDP growth was expected to average about 3.2 percent per year, with the unemployment rate settling at 5.1 percent and consumer price inflation at 2.4 percent. The 3-month Treasury bill rate was expected to average 4.1 percent, and the 10-year Treasury yield about 5.6 percent. These figures are a good measure of private forecasters' views of the performance of the economy along its "potential" growth path.

Blue Chip Economic Outlook, November 2004

	2003.4	2004.1	2004.2	2004.3	2004.4	2005.1	2005.2	2005.3	2005.4
	Actual				Projection				
Real GDP Growth	4.2	4.5	3.3	3.7	3.6	3.3	3.5	3.6	3.5
Unemployment Rate	5.9	5.6	5.6	5.4	5.4	5.3	5.3	5.2	5.2
CPI Inflation	0.7	3.5	4.8	1.9	2.5	2.2	2.2	2.2	2.3
3-month Treasury Bill	0.9	0.9	1.1	1.5	1.9	2.2	2.6	2.9	3.2
10-year Treasury Note	4.3	4.0	4.6	4.3	4.3	4.5	4.7	4.9	5.0

Fed Raises Rates Again

The Federal Reserve's Federal Open Market Committee [FOMC] – the group responsible for implementing monetary policy – met on November 10. Reflecting the ongoing strength in the economy, the FOMC raised its target interest rate – the Federal funds rate – by ¼ point, to 2 percent. This is the fourth ¼-point increase in interest rates by the FOMC since the end of June, when the Federal funds rate was at its cyclical low of 1 percent. The FOMC policy statement acknowledged the good economic outlook, saying: "Output appears to be growing at a moderate pace despite the rise in energy prices, and labor market conditions have improved. Inflation and longer-term inflation expectations remain well contained."

Prepared by **John H. Kitchen**
Chief Economist